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TAGS: [PREL](#) [ETRD](#) [EFIN](#) [EINV](#) [ARG](#) [UY](#)
SUBJECT: URUGUAY'S RELATIONSHIP WITH ARGENTINA: NOT THE
BEST OF TIMES

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Classified By: CDA ROBIN MATTHEWMAN, FOR REASON 1.4 (D)

Summary

¶1. (C) The relationship between Uruguay and Argentina, which has been strained since early 2006 by a dispute over the installation of a cellulose pulp plant on the Uruguayan shore of the Uruguay River, has continued to deteriorate. Political tensions, which range from the three-year long blockade of a bridge between Uruguay and Argentina by Argentine picketers to Uruguay's veto of Nestor Kirchner's proposed UNASUR presidency, have extended to other areas. On infrastructure, the GOA has not cleared the way for joint maintenance and dredging of a vital canal in the River Plate and has blocked Mercosur funding for the construction of an electricity connection between Brazil and Uruguay. Both projects are key for Uruguay's port infrastructure and electricity supply over the mid-term. Trade issues also represent a continued irritant, with the GOU particularly critical of Argentina's protectionist policies, including taxes on exports of raw materials and non-automatic import licenses. On the financial side, the GOU adamantly rejects perceived GOA accusations of Uruguay being a tax haven. Frictions have extended to the private sector and have reportedly affected Uruguay's national-flag airline Pluna, which was denied landing rights in an Argentine province. END SUMMARY.

POLITICAL FRICTIONS OVER UNASUR,S PRESIDENCY AND BOTNIA

¶2. (SBU) The Vazquez administration expected to have an extremely fluid relationship with the Kirchners' Argentina. Almost immediately after taking office, however, things changed for the worse as both administrations involved themselves in a harsh dispute over the installation of a cellulose pulp plant (Finnish Botnia) on the Uruguayan shore of the Uruguay River. In addition to legal actions between the two countries (the GOA filed a case against the GOU before the International Court of Justice in The Hague, which is pending, and the GOU filed a case against the GOA in Mercosur, which ruled in Uruguay's favor in 2006), a group of Argentine picketers have blocked a bridge that connects Argentina and Uruguay at the Uruguayan town of Fray Bentos for three years. That blockade has caused significant damage to Uruguay's economy. As a consequence, the GOU refused to support former Argentine President Nestor Kirchner's candidacy to preside over UNASUR, which operates via consensus, as long as the bridge remains blocked.

POLITICAL FRICTION EXTENDS TO INFRASTRUCTURE FINANCING...

13. (SBU) In turn, the GOA has blocked Mercosur's structural convergence fund (FOCEM) from funding the construction of an electricity frequency converter in the Uruguay-Brazil border. (Note: FOCEM is a \$100 million/year fund created in 2005 to finance development and infrastructure projects in Mercosur's smaller member countries as a way of reducing the oft-lamented "asymmetries" between the bloc's larger and smaller members. End Note.) Such a converter would enable Uruguay to import electricity from Brazil, which has become particularly critical in the face of periodic electricity shortages in recent years. Uruguay's Foreign Minister Gonzalo Fernandez specifically raised this issue during the July Mercosur Summit in Asuncion. Frente Amplio presidential candidate Jose Mujica also raised it in his August 4-6 trip to Brasilia where he met President Lula.

14. (SBU) The GOA has also blocked joint dredging operations to maintain the Martin Garcia canal in the Rio de la Plata. The maintenance, due to be performed and financed jointly by Argentina and Uruguay, is vital for the Uruguayan port of Nueva Palmira, a transshipment point from where most of Uruguay's pulp, paper, grains and oilseed exports are shipped. This has led the GOU to consider dredging the canal unilaterally, with a USD 60-80 million cost. Despite the GOU's intentions, it is unclear if the Treaty on the Joint Administration of the Rio de la Plata allows it to do so. The two sides have made no recent progress on this major irritant to the relationship.

TRADE DISPUTES...

15. (SBU) Argentina remains Uruguay's third most important export destination, after Brazil and China. However, sales to Argentina have fallen by 33 percent in the first seven months of 2009 over the same period of 2008, with the top ten export products declining between 24 percent and 100 percent. Consequently, Argentina's share in Uruguay's exports fell from 8 percent to 6 percent. After the recent Mercosur Summit, Minister of Economy Alvaro Garcia and Foreign Minister Gonzalo Fernandez accused the GOA of implementing protectionist policies. The GOU is most concerned about two main GOA trade measures: the imposition of non-automatic licenses and Argentina's export taxes.

16. (SBU) Argentina imposed non-automatic licenses on about 200 goods in November 2008, including imports from Mercosur members (Ref C). While not specifically targeted at Uruguay, the GOU has been critical of the measure. Licensing requirements only affect six percent of Uruguay's total exports to Argentina, but have a strong impact on specific sectors (e.g. textiles, apparel and plastic furniture) for which Argentina is Uruguay's principal export market. Sources in the textile industry recently told emboffs that the GOA is explicitly deterring importers from purchasing in Uruguay. However, Alvaro Ons, Director of Trade Policy in Uruguay's Ministry of Economy, told emboffs that, except for plastic furniture and wool suits, the GOA is being more expeditious in approving licenses to Uruguay than to other countries. Ons also said that Uruguay is not retaliating and has refrained from imposing protectionist measures.

17. (SBU) The GOU is also critical of the GOA's export taxes, which it maintains are prohibited by Mercosur rules. Export taxes reduce the price of raw materials in Argentina, increasing the competitiveness of Argentine industry. This has a three-pronged impact on Uruguay: it hurts Uruguay's competitiveness in Argentina, it curbs Uruguayan competitiveness vis--vis Argentina in third markets and it increases Argentina's competitiveness locally. Argentina's new inward trade policy is also perceived as a drag on

Uruguay's efforts, through Mercosur, to gain more market access in Europe, by bogging down the Mercosur-EU trade talks.

...AND FRICTIONS OVER TAXES AND THE FINANCIAL SECTOR

¶18. (SBU) Uruguay and Argentina are also at loggerheads over the exchange of information on taxes and capital markets issues. The GOA considers Uruguay a tax haven, a characterization that Uruguay adamantly rejects. During the Summit of Progressive Leaders held in Chile in March, President Vazquez publicly decried what he labeled as "rumors" suggesting Uruguay is a tax haven and explained the measures that his administration had taken to combat organized crime, drugs and money laundering. Regarding SAFIs (Uruguay's Societies for Financial Investment, which are thought by some to be conduits for illegal money transactions and tax evasion), Vazquez explained that the GOU prohibited the creation of new SAFIs in 2007 and that it will eliminate them entirely on January 1, 2010.

¶19. (C) The GOU believes that the GOA was behind the OECD's April 2009 decision to include Uruguay in the group of "non-cooperative jurisdictions with no commitment to implement the internationally agreed tax standard" (Ref B). Former Ministers of Economy Ignacio de Posadas (National Party) and Danilo Astori (ruling Frente Amplio) were quoted as saying that Argentina was attempting to provoke a crisis of confidence in the Uruguayan financial system. At that time, the GOU reacted swiftly and endorsed OECD's standards on transparency and exchange of information.

¶10. (SBU) In May 2009, in order to discourage capital flight from Argentina, the Argentine National Securities Commission prohibited stockbrokers and investment and trust-fund companies from operating financial instruments from a list of eighty tax havens, including Uruguay. In an unusual move, Uruguay's Central Bank issued a press release May 29 explaining that the Argentine delegation before the Mercosur Capital Markets Commission had refused to approve a Mercosur Framework Agreement on the "Exchange of Information and Reciprocal Assistance Among Mercosur's Capital Markets
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(##)the agreement in place, to provide information

to any of the three Mercosur members -- and especially Argentina -- in the framework established by the agreement." The press release stated that the Central Bank &has not received any information request from Argentina related to capital market operations in which Uruguayan firms participated.

¶11. (C) NOTE: In a conversation with emboffs on August 6 Daniel Espinosa, head of the Financial Unit at Uruguay's Central Bank, played down the conflict over financial issues. He said he understood that the GOA has a &real problem8 with capital outflows, and acknowledged that Argentines were using Uruguayan-sourced companies to take capital out from the country. He also explained that the proposed Mercosur agreement is good from a capital market standpoint, but falls short on tax and capital outflow issues, which is what Argentina is really after. He thought the GOA opted not to sign the agreement in order to avoid weakening its bargaining position vis--vis Uruguay. Concerning Uruguay's inclusion in the OECD's list, Espinoza said he doubted that Argentina had enough leverage to get Uruguay on the list. END NOTE.

POOR RELATIONS AFFECT A PRIVATE FIRM?

¶12. (SBU) In June 2009, Argentina's Transport Secretariat unexpectedly denied Uruguay's national flag airline, Pluna, rights to land in the southern Argentine province of Chubut. Pluna had requested seasonal international landing rights,

which were eventually granted to GOA-owned Aerolineas Argentinas.

BILATERAL RELATIONS

¶13. (C) There is a widespread perception in Uruguay that the relationship with Argentina is at its worst point in recent memory. Anibal Cabral, Director of Mercosur at Uruguay,s MFA, told us that there is a personal dislike between Vazquez and former Argentine President Kirchner. As Cabral put it, the Kirchners see President Vazquez as &a traitor8 for failing to appropriately accommodate Argentine concerns and build a better relationship despite the problems described herein. As a graphic demonstration, the Argentine government instructed its ambassador to forego the usual national day reception at Mercosur headquarters on May 25. At a small wreath-laying ceremony, the Argentine ambassador made an impassioned personal speech, emphasizing the importance of both sides finding a way to overcome the current tensions.

¶14. (SBU) And finally, the issue has touched the current presidential campaign as well. Ruling FA presidential candidate Mujica has been harshly criticized for having met the Kirchners in an October 2008 trip to Buenos Aires. Since then, Mujica has tried to disassociate himself from the GOA, acting with redoubled vigor after former President Nestor Kirchner publicly supported his candidacy on April 22. Matthewman